



MONTANA LEGISLATIVE BRANCH

Legislative Fiscal Division

Room 110 Capitol Building * P.O. Box 201711 * Helena, MT 59620-1711 * (406) 444-2986 * FAX (406) 444-3036

Legislative Fiscal Analyst
CLAYTON SCHENCK

DATE: November 8, 2002

TO: Legislative Finance Committee

FROM: Clayton Schenck

RE: Securitization of Tobacco Funds

The purpose of this memo is to provide the Legislative Finance Committee with preliminary information about what proceeds might be obtained if the legislature were to sell anticipated future tobacco funds for an immediate pay-off. This is in response to a committee request for this information at the October meeting, after hearing that 14 states have already securitized tobacco revenues, and that other states are considering this option.

ESTIMATED PROCEEDS FROM THE SALE OF TOBACCO REVENUES

The state's financial advisor, Jonathan Heroux of U.S. Bancorp Piper Jaffray, was requested to provide a rough estimate of the potential proceeds that might be obtained from the sale of the state's future tobacco fund revenue stream for an immediate pay-off. For the purpose of the calculation, it was assumed that the portion of the proceeds that go into the constitutional tobacco trust fund (40 percent) would not be sold, and that only 60 percent would be securitized. It must be emphasized that the following is a very rough estimate, and actual amounts from negotiated sales could vary significantly.

The state financial advisor stressed that estimating what type of discount is being used is not an easy one to answer. He stated that "the rating agency's have what is called a 'Monte carlo model' which test and stresses the potential future stream of tobacco revenue coming to particular states using various assumptions about smoking rates and expected price increases. The net result is they determine how much a state could bond against assuming a rating target for the bonds."

In providing an estimate, Mr. Heroux assumed there would be about \$18 million (60% of an estimated \$30 million annual revenues) available to bond against. His calculations concluded that the state would be able to bond for an estimated \$6 million a year in debt service. He took into consideration how past tobacco issues have come to the market, and reached the conclusion that the state has the potential to raise about \$84 million in immediate tobacco bond proceeds, in lieu of the current \$18 million per year annual income for 30 years. The attached calculation table from Mr. Heroux reflects that conclusion.

POTENTIAL IMPACT ON STATE BOND RATING?

Mr. Heroux was also asked to comment on a concern that states that securitized their tobacco funds were experiencing a negative impact on their bond ratings. He responded that the negative impact from a rating agency standpoint probably relates to an underlying fundamental concern with a given state's finances, and not necessarily with the issuance of tobacco bonds. He stated that the concern for a bond rater would arise from a states proceeding with tobacco bonds as a "quick/short term" fix for long-term problems/challenges.

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